

Message Text

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ACTION EUR-12

INFO OCT-01 EA-10 IO-13 ISO-00 CIAE-00 DODE-00 NSAE-00
NSCE-00 SSO-00 ICAE-00 INRE-00 SP-02 AID-05 EB-08
SS-15 STR-07 OMB-01 CEA-01 FRB-03 INR-10 XMB-02
OPIC-03 LAB-04 SIL-01 L-03 H-01 PA-01 /103 W
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O P 111709Z MAY 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC IMMEDIATE 6040
TREASURY DEPT WASHDC PRIORITY
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY COPENHAGEN
AMEMBASSY DUBLIN
AMEMBASSY THE HAGUE
AMEMBASSY LUXEMBOURG
AMEMBASSY ROME
AMEMBASSY TOKYO
USDOC WASHDC
USMISSION GENEVA
USMISSION USNATO
AMCONSUL BELFAST
AMCONSUL EDINBURGH

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USEEC ALSO FOR EMBASSY
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USMTN

E.O. 11652: N/A
TAGS: PINT, PGOV, EFIN, UK
SUBJECT: GOVERNMENT LOSES SECOND VOTE ON FINANCE BILL

REF: LONDON 7307
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SUMMARY: THE "GRAND COALITION" OF OPPOSITION PARTIES
BROKE DOWN MAY 10, BUT NOT BEFORE IT AGAIN DEFEATED
THE GOVERNMENT ON THE FINANCE BILL, THIS TIME RAISING
THE THRESHOLD FOR HIGHER INCOME TAX RATES BY ONE
THOUSAND POUNDS. COST TO THE TREASURY: 105 MILLION

POUNDS THIS YEAR AND 150 MILLION IN FUTURE YEARS. SUBSEQUENT AMENDMENTS TO BRING FURTHER RELIEF TO UPPER INCOME LEVELS WERE DEFEATED BY INCREASING GOVERNMENT MARGINS. CHANCELLOR HEALEY, IN A FURTHER EFFORT TO REASSURE FOREIGN OBSERVERS, SAID THE GOVERNMENT WOULD TRY TO RESTORE THE BILL TO ITS ORIGINAL FORM AT THE REPORTS STAGE IN JULY. THE DEFEAT OF THE GOVERNMENT ON THESE TWO AMENDMENTS SHOULD HAVE NO EFFECT ON ITS CONTINUATION IN POWER, BUT INFERRED INCREASES IN THE PUBLIC SECTOR BORROWING REQUIREMENT COULD UNDERMINE ITS BUDGET STRATEGY. END SUMMARY.

1. THE OPPOSITION PARTIES REMAINED TOGETHER LONG ENOUGH MAY 10 TO AMEND THE/FINANCE BILL AGAIN, THIS TIME BY RAISING THE INCOME TAX THRESHOLD BETWEEN THE STANDARD AND HIGHER RATES BY A THOUSAND POUNDS. THE VOTE WAS 288 TO 286 AGAINST THE GOVERNMENT. THE ESTIMATED COST TO THE EXCHEQUER IS 105 MILLION POUNDS FOR THE CURRENT YEAR, AND 150 MILLION THEREAFTER. THIS BRINGS THE TOTAL COST OF BOTH AMENDMENTS TO ABOUT 450 MILLION. BUT THE GRAND COALITION OF OPPOSITION PARTIES HAD ALREADY BEGUN TO FALL APART -- THE WELSH NATIONALISTS SUPPORTED THE GOVERNMENT -- AND ITS DISINTEGRATION CONTINUED, WITH THE GOVERNMENT DEFEATING LATER AMENDMENTS BY STEADILY INCREASING MARGINS.

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2. CHANCELLOR HEALEY LATER AFFIRMED THAT THE GOVERNMENT WOULD SEEK TO OVERTURN BOTH AMENDMENTS WHEN THE BILL RETURNS TO THE FLOOR OF COMMONS IN JULY FOR ITS REPORTS STAGES. HIS HASTE TO MAKE THIS POINT STRONGLY SUGGESTS THAT HE PLACED A HIGH PRIORITY ON TRYING TO REASSURE FOREIGN EXCHANGE MARKETS AND INVESTORS. THIS STATEMENT ALSO REINFORCES HIS EARLIER PLEDGE TO HOLD THE PSBR TO THE 8.5 BILLION LIMIT AND HIS DISCUSSION OF VARIOUS TAX OPTIONS (REFTEL).

3. WHILE THE FINANCE BILL NOW LEAVES THE FLOOR OF THE COMMONS FOR THE COMMITTEE ROOMS, THE GOVERNMENT'S TROUBLES ARE NOT NECESSARILY OVER. THE SELECT COMMITTEE WHICH WILL BE EXAMINING IT CAN RECOMMEND ADDITIONAL SUBSTANTIVE AMENDMENTS, WHICH MUST BE APPROVED BY COMMONS BEFORE TAKING EFFECT, THAT COULD FURTHER THREATEN THE GOVERNMENT'S BUDGET STRATEGY. THE MAKE-UP OF THE COMMITTEE IS SUCH THAT THE ECONOMIC SPOKESMEN OF THE LIBERAL AND ULSTER UNIONIST PARTIES -- JOHN PARDOE AND ENOCH POWELL -- WILL HOLD THE BALANCE.

4. COMMENT: PERHAPS EVEN MORE DISTURBING FOR

CALLAGHAN (AND HEALEY) THAN LAST NIGHT'S DEFEAT WAS THE FACT THAT THE VOTE WAS LOST THROUGH POOR MANAGEMENT BY THE WHIP'S OFFICE. ONCE AGAIN A LABOR MP SLEPT THROUGH THE DIVISION, WHILE TWO LABOR SUPPORTERS FAILED TO SHOW UP AND A CONSERVATIVE MP BROKE AN OFFICIAL PAIR BY VOTING. OTHERWISE, THE POLITICAL EFFECTS OF THE TWO REVERSALS HAVE BEEN MINIMAL. AT THIS POINT THE GOVERNMENT DOES NOT CONSIDER THAT ITS BUDGET STRATEGY HAS

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TO SECSTATE WASHDC IMMEDIATE 6041

TREASURY DEPT WASHDC PRIORITY

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BEEN SIGNIFICANTLY DAMALED, BUT IT ACKNOWLEDGES THAT ALL OF THE EFFECTS OF THESE ACTIONS HAVE NOT PLAYED OUT. ALTHOUGH THERE HAS BEEN SOME SPECULATION THAT THE

GOVERNMENT MIGHT BE FORCED TO PUT DOWN A MOTION OF
CONFIDENCE, WE DO NOT BELIEVE SUCH AN ACTION IS LIKELY.
IF, HOWEVER, A CONFIDENCE SITUATION SHOULD EVENTUATE,
WE DO NOT BELIEVE THE GOVERNMENT WOULD BE IN REAL
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JEOPARDY -- THE OPPOSITION ALLIANCE WAS ENTIRELY CIRCUM-
STANTIAL AND, IF ANYTHING, THE VARIOUS PARTIES HAVE EVEN
LESS BASIC COHESION THAN A YEAR AGO.

5. WHERE THE GOVERNMENT GOES FROM HERE WITH THE FINANCE
BILL IS UNCERTAIN AND WILL HINGE ON WHAT HAPPENS IN
COMMITTEE AND HOW FINANCIAL MARKETS REACT TO THE AMEND-
MENTS ALREADY APPROVED. THERE IS NO DOUBT THAT HEALEY
WOULD LIKE TO HAVE THE BILL RESTORED TO ITS ORIGINAL
FORM. NOT ONLY WOULD IT REASSURE THE MARKETS, BUT IT
WOULD ALSO GIVE HIM GREATER FLEXIBILITY SHOULD CALLAGHAN
OPT FOR A GENERAL ELECTION IN THE FALL OR SPRING OF 1979.
BUT RIGHT NOW IT SEEMS UNLIKELY THAT THE GOVERNMENT WILL
HAVE THE VOTES IN JULY NEEDED TO REPEAL THE AMENDMENTS.
HEALEY MIGHT THEN BE FORCED TO INCREASE TAXATION TO
KEEP THE PSBR BELOW THE 8.5 BILLION POUND CEILING (HE
HAS ALREADY RULED OUT PUBLIC SPENDING CUTS).

6. EVEN ASSUMING THE SELECT COMMITTEE DOES NO FURTHER
DAMAGE TO THE BILL AS IT NOW STANDS, THE GOVERNMENT
COULD FIND ITS BUDGET STRATEGY UNDERMINED. AS A RESULT
OF THESE PROPOSED TAX CUTS, PERSONAL DISPOSABLE INCOME
WOULD BE INCREASED BY NEARLY 500 MILLION POUNDS IN
ADDITION TO THE 2.5 BILLION POUND STIMULUS PROVIDED IN THE
BUDGET AND THE PSBR WILL BE INCREASED BY A LIKE SUM
(IT IS IMPORTANT TO NOTE, HOWEVER, THAT THE TREASURY
TENDS TO OVERESTIMATE THE PSBR, AND BY JULY IT SHOULD
BE EVIDENT WHETHER IT HAD DONE SO AGAIN). THE POTENTIAL
CHAIN OF NEGATIVE EFFECTS COULD INCLUDE THE FOLLOWING:
UPWARD PRESSURE ON THE MONEY SUPPLY WOULD LEAD TO HIGHER
INTEREST RATES IF THE GOVERNMENT HAD TO INCREASE ITS
BORROWING; THE CURRENT ACCOUNT WOULD DETERIORATE IF,
AS EXPECTED, HIGHER PERSONAL INCOMES SUCK IN MORE
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IMPORTS; AND STERLING COULD COME UNDER INCREASED PRESSURE
ON FOREIGN EXCHANGE MARKETS. IT WAS PRECISELY THESE
CONSIDERATIONS THAT CAUSED HEALEY TO EMPHASIZE HIS
INTENTION TO HOLD TO THE PSBR LIMIT AND PROMISE, IF
NECESSARY, OFFSETTING TAX INCREASES.

BREWSTER

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